

VZCZCXYZ0002
RR RUEHWEB

DE RUEHLI #2438/01 2621515
ZNR UUUUU ZZH
R 191515Z SEP 07
FM AMEMBASSY LISBON
TO RUEHC/SECSTATE WASHDC 6273
INFO RUCNMUC/EU CANDIDATE STATES COLLECTIVE
RUCNMEM/EU MEMBER STATES COLLECTIVE
RUEATRS/DEPT OF TREASURY WASHDC
RUEHXX/ARAB ISRAELI COLLECTIVE

UNCLAS LISBON 002438

SIPDIS

SIPDIS

E.O. 12958: N/A

TAGS: [EFIN](#) [ECON](#) [EUN](#)

SUBJECT: INFORMAL ECOFIN/EUROMED: EU ECONOMY SOUND, FOCUS
ON FINANCIAL INNOVATION, STABILITY, AND PUBLIC
ADMINISTRATION

Summary

1. On September 14-15, EU Finance Ministers, Central Bank Governors and Commissioners joined together in an informal ECOFIN gathering focused on state of the economy, fiscal consolidation and structural reform. Eurozone peer pressure would be necessary to keep France on track to reduce its deficit. The EU announced its support for Strauss-Kahn as IMF Managing Director and for Padoa-Schioppa as IFC Chairman and indicated its willingness to discuss amending the IMF selection process. There was universal praise for the European Central Bank's response to recent market volatility. Talks also focused on financial innovation, financial stability and modernization of public finances. The informal gathering concluded with EUROMED discussions with southern Mediterranean officials on how best to create employment and stimulate growth.

Eurozone Economy Healthy

2. Eurogroup discussions focused on the fundamental sound health of the Eurozone economy, with Eurogroup President and Luxemburg Finance Minister Juncker welcoming Cyprus and Malta to the discussions. Juncker and Economy and Monetary Affairs Commissioner Almunia acknowledged that increased risks brought about by developments in the financial markets would have a slight negative impact on 2007 growth but did not foresee any dramatic revision of 2008 growth projections, either to the Eurozone or to the EU at large. European Central Bank (ECB) President Trichet concurred with this assessment. Almunia was optimistic about the future and noted it was essential to stick to the principles of structural reform and fiscal consolidation) a strategy which explained the zone,s current good figures. In addition, strong domestic demand, employment growth, strong EU companies' balance sheets, and banking solidity helped Europe weather the current financial market volatility. World growth remained robust with the increase in developing countries' GDP countering the slowdown in the U.S. economy. On inflation, Trichet noted projections remained the same while Almunia said tightening labor markets and increased food prices could produce inflationary tensions.

France's Budget Proposal not as Ambitious as Structural Reform

3. French Finance Minister Lagarde provided a detailed readout of France's proposed structural reforms which covered an impressive range of sectors. Juncker noted that such reforms were part and parcel of the Lisbon Agenda, and if applied appropriately, would have a positive effect on the country,s growth. However, France's minimal budget ambition was another matter and not in line with the Eurogroup,s

expectations. The Eurogroup underscored to France that fiscal consolidation and structural reform go hand in hand, and that Growth and Stability Pact commitments made in Berlin still applied. They expected France to cut back on public expenditure, and if tax revenues were high enough, the government would need to reduce debt accordingly. The group made it clear that France was expected to lower its deficit by 2010, not 2012 as France proposed. Discipline and continued Eurogroup peer pressure were key, Almunia noted. He had revised 2007 growth projections for France downward. There would be a more complete review of France's proposal in October.

IMF) Changes in Selection Process Possible

14. Portuguese Finance Minister Teixeira dos Santos, as EU President Chair, announced the Union's support for Dominique Strauss-Kahn as IMF Managing Director and for Italian Finance Minister Tommaso Padoa-Schioppa as International Finance Committee (IFC) Chairman. He confirmed that the informal gathering discussed possible changes to the IMF senior leadership selection process (post Strauss-Kahn) to enhance the role of developing nations. Almunia underscored that such changes would be not be done in isolation and that other major international organization (i.e. World Bank) would have to undertake similar commitments. Teixeira dos Santos also noted the EU's proposal to establish a three-year term limit for IFC chairmanship and to establish a rotating system.

ECB Praised for Handling of Sub-Prime Crisis

15. Internal Market and Services Commissioner McGreevy noted that while poor quality sub-prime mortgage lending had originated in the U.S., its effects were being felt worldwide, testing the capacity of EU supervisory and regulatory authorities. The informal gathering repeatedly

expressed satisfaction with the European Central Bank (ECB)'s operations over the summer, with Juncker underscoring the importance of a single, unified response rather than thirteen disparate reactions. Trichet noted that while market corrections were still ongoing, the ECB's actions had permitted the money market, in particular the short-term money market, to function as well as possible. McGreevy also noted that there was sufficient core capital to cover the current risk which still required close monitoring.

Financial Innovation a Constant Challenge

16. Financial innovation presented a constant challenge for supervisory authorities, Teixeira dos Santos noted. In this context, the gathering a communique calling for increased transparency of financial instruments, institutions and vehicles and improved valuation processes, risk management and liquidity testing. McGreevy noted that while the Economic and Financial Committee (EFC) was seeking to promote cross-border harmonization, it was not seeking to promote a single supervisory authority. He commented that the Solvency II Directive could become a template for banking. The EFC also planned to look into the role of rating companies and their effect on the market.

Financial Stability Report Supported

17. The informal gathering agreed with the EFC's financial stability report conclusions calling for broader risk management resources and the elimination of legal and fiscal barriers. The gathering also debated extending the 2005 MOU on banking supervisory authority to include a common analytical framework to evaluate crises and to develop specific cross border cooperation mechanisms. Also under discussion was the EU securities' clearance and settlement system, with particular attention paid to enhancing post settlement mechanisms and implementing the code of conduct. (Note: The EFC is examining an ECB proposal to establish a single settlement platform. End Note.) Burden sharing concerns were also put on the table.

Public Finances Need to be Modernized

¶8. The informal gathering discussed the importance of modernizing public finances, with a specific emphasis on efficiency to increase competitiveness. Guest speaker World Bank Vice President for Private Sector Development Michael Klein illustrated how countries that had modernized public finances had experienced real increases in growth and wealth. The ministers exchanged best practices on modernizing budgetary techniques, planning and performance measurement. Almunia noted the discussion would continue well into the Slovenian presidency.

EuroMed) Working Together to improve Growth and Employment

¶9. The informal gathering also included a meeting of EuroMed officials, with representatives from Egypt, Algeria, Morocco, Israel, the Palestinian Authority, Tunisia, and Syria in attendance. Discussions focused on improving the quality of public finances, the development of financial markets, and priorities for development as outlined in the 2005 Rabat Conference. The group also discussed the creation of a EuroMed network of financial experts to exchange best practices. Almunia underscored the importance of working to improve economic growth and employment in southern Mediterranean countries, noting that two-thirds of EU investment flows to the region, having doubled since 2004.

Comment

¶10. Camaraderie among ministers, bank governors and commissioners was evident. There was clear praise for the Portuguese Presidency and its handling of the meeting and issues as well as for the European Central Bank and its reaction to the recent market volatility. Teixeira dos Santos, in particular, continues to enjoy a strong reputation within the EU.
Hoffman